

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION FOR RATE ADJUSTMENT)
FOR SMALL UTILITIES OF LEXINGTON) CASE NO. 9069
SOUTH ELKHORN WATER DISTRICT)

O R D E R

On May 30, 1984, Lexington South Elkhorn Water District ("South Elkhorn") filed its application in accordance with 807 KAR 5:076 alternative rate adjustment procedures for small utilities which allows a utility with less than 400 customers or \$200,000 in gross annual revenue to file an abbreviated application and seek expedited regulatory treatment. In its application, South Elkhorn requested to increase its rates by \$70,355. In this Order the Commission has allowed South Elkhorn to increase its rates by \$29,681.

TEST PERIOD

South Elkhorn has proposed and the Commission has accepted the 12 months ending December 31, 1983, as the test period in this proceeding.

REVENUES AND EXPENSES

South Elkhorn had an actual test period net operating loss of \$52,899. South Elkhorn proposed pro forma adjustments to its actual test period operations which increased its operating loss to \$62,518. These adjustments included but were not limited to:

an increase in operating revenue and purchased water expense to reflect customer growth and the increase in rates being charged for purchased water by its supplier, Kentucky-American Water Company; an increase in purchased power cost; a meter testing program as required by 807 KAR 5:066; and a program for maintenance of hydrants and pumps. The Commission has accepted South Elkhorn's adjustments with the following exceptions:

Purchased Power

South Elkhorn originally proposed to increase its operating expenses by \$7,100 to reflect the cost of operating an existing pump station in order to alleviate chronic pressure problems within certain parts of its service area. The pump had not been used until late 1983 and subsequently this cost was not reflected in the test period operating expenses.

In response to the Commission's information request of August 23, 1984, filed August 31, 1984, South Elkhorn reduced this expense by \$880 to \$6,220.¹ The Commission finds this adjusted expense level to be reasonable and has accepted it for rate-making purposes.

System Maintenance

During the test period South Elkhorn incurred a \$22,063 expense for non-recurring repairs to the system's pumping and storage system which it proposed to amortize over a 5-year period. The Commission, after reviewing the invoices submitted for these

¹ Item 1c, Pages 122.

repairs, has determined that they added substantially to the useful life of the pumping system at a minimum of 10 years, which is the period of time used by the Commission to amortize this non-recurring expense. Therefore, the Commission has reduced South Elkhorn's maintenance expense to \$16,706, a reduction of \$2,294.

Maintenance of Hydrants

South Elkhorn proposed to increase its maintenance expenses by \$1,250 to reflect the cost of maintaining its hydrants. This included the annual cost of painting the hydrants over a 5-year cycle and the cost of flushing the hydrants.² During the test period South Elkhorn incurred operating expenses of \$785 for hydrant flushing.³ Since South Elkhorn made no adjustment to eliminate test period expenses in its pro forma calculation, the Commission has reduced this expense by \$785 to \$465.

Outside Services

South Elkhorn had actual test period expenses for outside services of \$27,499 which it proposed to adjust to \$36,164, an increase of \$8,665. This adjustment included an expense reduction of \$5,500 in engineering costs and increases in expenses of \$1,825 for EPA monitoring, \$3,750 for a growth study plan, \$1,000 for pressure monitoring, \$4,790 for rate case expenses and \$2,800 for

² Item 1g of application, pages 11-13.

³ Item 4g of response to August 23, 1984, information request.

preparation of funding applications to be submitted to various agencies seeking funding for South Elkhorn's anticipated expansion.⁴ The Commission is of the opinion that the reduction for engineering costs should be amortized over a 10-year period while the increase for the growth study plan should be amortized over a 5-year period since the benefits to be derived from the expenditures should be realized for these periods of time.⁵ Furthermore, the Commission is of the opinion that the rate case expenses and the funding application expense should be amortized over a 3-year period. In addition to the above adjustments, the Commission is of the opinion that \$4,600 included in the 1983 engineering costs for distribution main extensions, inspection, as-builts, agreements, etc.,⁶ should be capitalized rather than expensed. Therefore, the Commission has reduced the pro forma outside services expense by this amount. The Commission has adjusted depreciation expense to include the effects of capitalization of these items on depreciation. The total effect of the above adjustments is to reduce pro forma outside services expense by \$12,110, from \$36,164 to \$24,054.

Miscellaneous General Expenses

South Elkhorn experienced legal expenses during the test period for litigation against the District and for purchased water

⁴ Item K of the application, pages 14-16.

⁵ Response to information request of August 23, 1984. Item 7(K) a, b, c, d.

⁶ Response to Commission information request of August 23, 1984. Item 7K, page 18.

contract negotiations. These expenses are expected to amount to \$1,860. The Commission is of the opinion that these costs are non-recurring in nature and should be amortized over a 3-year period.⁷ This reduces pro forma miscellaneous general expenses by \$1,240, from \$8,744 to \$7,504.

Accounting and Collecting Labor

South Elkhorn proposed to increase its accounting and collecting labor from \$1.15 to \$1.50 per meter per month. However, in the appendix to its application, South Elkhorn provided a fee schedule for outside services, dated January 6, 1984, listing this fee at only the \$1.15 level. The contract approving the \$1.15 was ratified by South Elkhorn in 1979.

Since South Elkhorn did not substantiate the increase in accounting and collecting labor from \$1.15 to \$1.50 the Commission will hold this expense to the test period level of \$1.15. Therefore, the Commission has reduced this expense by \$1,310 from \$10,225 to \$8,915.

Administrative and General Salaries

South Elkhorn proposed to increase administrative and general salaries by \$3,100 to reimburse the bookkeeper for office space, equipment, files and meeting room facilities provided previously without compensation. While this increase appears to be reasonable, it has not been presented to South Elkhorn's

⁷ Response to Commission information request of August 23, 1984. Item 8M.

Commissioners for approval and will be deferred at the request of South Elkhorn's manager/bookkeeper until South Elkhorn is in a more stable financial condition.⁸ Since the timing of this increase is in doubt and no proposal has been made to South Elkhorn's Commissioners, the Commission is of the opinion that the proposed increase fails to meet the known and measurable criterion for inclusion for rate-making purposes. Therefore, the Commission has reduced South Elkhorn's pro forma expense by this amount. Further the Commission has increased the expense by \$360 to reflect the additional contractual costs incurred by South Elkhorn due to the addition of 30 new customers.

The net effect of these adjustments is to reduce the pro forma expense for administrative and general salaries by \$2,740.

Depreciation Expense

South Elkhorn had a test period depreciation expense of \$20,905 which it proposed to increase to \$23,050. In calculating its depreciation expense, South Elkhorn included depreciation on contributed property. It is this Commission's policy to compute depreciation on property based on a utility's investment in that property. Therefore, the Commission does not, for rate-making purposes, allow depreciation expense on contributed property. Based on South Elkhorn's average depreciation rate of 2.5 percent⁹

⁸ Response to Commission information request of August 23, 1984. Item 6V.

⁹ From the 1983 Annual Report:

Depreciation Expense of \$20,905 ÷ total plant in service of \$848,600 = 2.5 percent.

and including the capitalized engineering fees discussed earlier, the Commission has determined the allowable depreciation expense for rate-making purposes to be \$4,954,¹⁰ a reduction of \$18,096 to South Elkhorn's pro forma expense.

Interest on Long Term Debt

South Elkhorn has included interest expense of \$9,150 in its operating expenses. This expense is directly related to South Elkhorn's current bonded indebtedness to Farmer's Home Administration and should be included in calculating the debt service requirement of South Elkhorn. Therefore, the Commission has reduced the pro forma operating expenses by this amount.

Therefore, the Commission is of the opinion that South Elkhorn's adjusted test period operations can be stated as follows:

	<u>Actual</u>	<u>Adjustments</u>	<u>Adjusted</u>
Revenues	\$144,470	\$ 8,390	\$152,860
Operating Expense	<u>197,369</u>	<u><30,596></u>	<u>166,773</u>
Net Operating Loss	<u>\$<52,899></u>	<u>\$ 38,986</u>	<u>\$<13,913></u>

10	Plant in Service	\$848,600
	Capitalized Engineering Fees	4,600
	Subtotal	\$853,200
	Less:	
	Contribution in Aid of Construction	655,057
	Net Depreciation Plant	<u>198,143</u>
	Average Depreciation Rate	2.5%
	Allowable Depreciation Expense	\$ 4,954

REVENUE REQUIREMENTS

South Elkhorn has an average debt service requirement of \$13,140.¹¹ South Elkhorn's Commission adjusted operations result in a negative debt service coverage ("DSC"). The Commission is of the opinion that this is unfair, unjust and unreasonable in that it will not allow South Elkhorn to provide for its operating expenses or meet its debt service requirements. The Commission is further of the opinion that a DSC of 1.2X is fair, just and reasonable in that it will allow South Elkhorn to provide for its operating expenses, meet its debt service requirements and allow for reasonable equity growth. Therefore, the Commission will allow South Elkhorn to increase its rates and charges to produce an additional \$29,681¹² on an annual basis.

BILLING ANALYSIS

In its application, South Elkhorn stated that it expects to connect 30 new customers whose average use will be 10,000 gallons

11	Principal and Interest for	1985	\$13,150
		1986	12,950
		1987	12,750
		1988	13,550
		1989	13,300
			<u>\$65,700</u>
		Average	\$13,140
12	Adjusted Operating Expenses		\$166,773
	1.2X DSC		15,768
	Subtotal		<u>\$182,541</u>
	Less: Pro Forma Revenues		<u>152,860</u>
	Increase Required		\$ 29,681

per customer per month.¹³ These new customers were included in adjustments made to expenses. The Commission has, therefore, adjusted the billing analysis to include the usage projected for these customers and has based the rates granted herein on the adjusted usage.

RATE DESIGN

South Elkhorn presently has separate declining block rate schedules for 5/8-inch X 3/4-inch, 3/4-inch, 1-inch, 1 1/2-inch and 2-inch meters. It has proposed to delete the rate schedules for 3/4-inch and 1 1/2-inch meters since no meters of these sizes are currently in use or anticipated to be used. The Commission is of the opinion that such deletion is reasonable and should be approved.

South Elkhorn further proposed to change the rate design of the remaining rate schedules by combining usage blocks and, thus, reducing the number of rate steps for the 5/8-inch X 3/4-inch and 1-inch meters, and lowering the usage levels in both the minimum and last rate block for 1-inch and 2-inch meters. In addition, South Elkhorn proposed an inverted block rate design for all customers whereby the cost would increase with the greater volume of usage rather than decline as in the present rate design. This would result in increases ranging from 0 percent for standard meter customers using 2,000 gallons or less per month to 161 percent for customers using 100,000 gallons or more per month.

¹³ Application, Section 2.

In support of this proposal, South Elkhorn filed a detailed study of its water usage pattern and offered arguments to show benefits to the utility and its customers.¹⁴ The inverted block rate design is a relatively untried concept in utility pricing although it has been the subject of discussion for some time. Further, the record shows that approximately 95 percent of South Elkhorn's customers would be affected by this change. For these reasons, the Commission is of the opinion that the alternative rate adjustment procedure under which this case is filed is not appropriate for a determination as to a change of this magnitude.

FINDINGS AND ORDERS

The Commission, after examining the evidence of record and being advised, is of the opinion and finds that:

1. The rate schedules for 3/4-inch and 1 1/2-inch meters should be deleted from South Elkhorn's tariff.

2. The changes in rate design proposed by South Elkhorn should be denied at this time.

3. The rates proposed by South Elkhorn are unfair, unjust and unreasonable and should be denied.

4. The rates in Appendix A are the fair, just and reasonable rates to be charged and should be approved.

IT IS THEREFORE ORDERED that the rate schedules for 3/4-inch and 1 1/2-inch meters be and they hereby are deleted from

¹⁴ Application, Section III and IV.

South Elkhorn's tariff effective on and after the date of this Order.

IT IS FURTHER ORDERED that the changes in rate design proposed by South Elkhorn be and they hereby are denied.

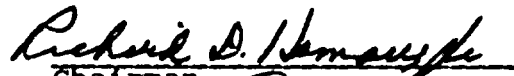
IT IS FURTHER ORDERED that the rates proposed by South Elkhorn be and they hereby are denied.


IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are approved for services rendered on and after the date of this Order.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, South Elkhorn shall file its revised tariff sheets setting out the rates and charges approved herein.

Done at Frankfort, Kentucky, this 24th day of October, 1984.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 9069 DATED October 24, 1984.

The following rates are prescribed for customers receiving water service from Lexington-South Elkhorn Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

5/8-inch X 3/4-inch Meters

<u>Usage Blocks</u>		<u>Monthly Rates</u>
First	2,000 gallons	\$9.95 per 1,000 gallons
Next	2,000 gallons	2.60 per 1,000 gallons
Next	2,000 gallons	2.00 per 1,000 gallons
Next	10,000 gallons	1.70 per 1,000 gallons
Next	8,000 gallons	1.50 per 1,000 gallons
Over	24,000 gallons	1.25 per 1,000 gallons

1-inch Meters

<u>Usage Blocks</u>		<u>Monthly Rates</u>
First	10,000 gallons	\$25.80 Minimum
Next	6,000 gallons	1.70 per 1,000 gallons
Next	8,000 gallons	1.50 per 1,000 gallons
Over	24,000 gallons	1.25 per 1,000 gallons

2-inch Meters

<u>Usage Blocks</u>		<u>Monthly Rates</u>
First	24,000 gallons	\$48.15 Minimum
Over	24,000 gallons	1.25 per 1,000 gallons